

Bundy & Morrill, Inc., P.S.

BUSINESS, FRANCHISE & DISTRIBUTION LAW

12351 Lake City Way NE, Suite 202
Seattle, WA 98125-5437
Tel: (206) 367-4640
Fax: (206) 367-5507
bundy@bundymorrill.com
www.bundymorrill.com

Howard E. Bundy
Howard R. Morrill

November 12, 2004

Secretary
Federal Trade Commission
Room H-159 (Annex W)
600 Pennsylvania Ave, N.W.
Washington, D.C. 20580

**RE: 16 C.F.R. Part 436 – Franchise Rule
Comment on Staff Report**

Dear Secretary:

I want to thank the Commission and the staff—and especially Steven Toperoff—for the enormous amount of work and effort that has gone into producing the proposed revised rule and the Staff Report. Generally speaking, you have done a great deal to address some of the major problems with the regulation of franchising. Although I may differ with your tentative conclusions on specific issues, I applaud your efforts and your balanced approach. I have previously commented extensively on many of the issues involved and will strive (in most cases) to not repeat myself. Suffice it to say, the Commission well understands my belief that the purpose of the Franchise Rule should be to protect franchisees from fraud and deceptive practices—and not to give franchisors a “road map” on how to get away with fraud and misrepresentation.

I begin with the hopefully not naïve belief that the vast majority of the problems in franchising, and especially of pre-sale problems, do not involve the large nationally known franchisors that come to mind when someone says the word “franchise”. I also understand that those large, well-known franchisors have to spend a relatively small portion of their budget complying with the Franchise Rule and applicable state regulation in most cases.

In my view, the Franchise Rule is most important in addressing the problems of relative new-comers to franchising—generally, those with less than about 500 outlets and/or less than ten years of franchise experience. The biggest problems manifest themselves in the “fad franchises” (think muffins, bagels, and recently women’s fitness) and “low budget” franchises (think janitorial and mobile automotive repair). Those are the types of franchises where, upon close analysis, the franchisor is most likely viewing franchising as an affordable alternative to selling securities. They are the least likely to have competent counsel and other good advisors. Those are the franchisors who will look at a regulation

such as the Franchise Rule and try to use minimalistic “technical” compliance as a “shield” against liability or administrative consequences. To that end, the Franchise Rule needs to make it unmistakably clear that such minimal compliance does not provide a “safe harbor”—that the franchisor must also comply with every other requirement of the law, both statutory and common law. The Franchise Rule needs to be so clear and direct that no one can fail to understand the broad scope of disclosure that it, in fact, requires.

Corporate Accountability.

To that end, I very much commend the Commission for holding accountable every person in the corporate structure of a franchisor who has “authority to control” the contents of the Disclosure Document. This is consistent with what Congress and the SEC have mandated in the post-Enron world with regard to officers of a public corporation. It is important to force responsibility for the accuracy and completeness to the highest levels in the franchisor’s organization to avoid the scenario where franchise compliance is bureaucratically isolated from the information that the franchisor is required to disclose. The buck has to stop only at the top.

Additional Disclosures.

I share with David Kaufmann a concern about the continuing lack of guidance on how franchisors should handle additional disclosures required by Section 5 of the FTC Act, some state laws and by the common law. I urge the commission to address this. It is extremely risky for both parties to leave it to purely oral disclosures, to a separate document, to a series of seemingly inconsequential letters, or otherwise to a haphazard approach to such additional disclosures. I offer a simple proposal: The FTC should require the addition of an “ITEM 24” to the Disclosure Document (probably redesignating the current 23 as 24 and inserting the new Item as 23). The Item could be captioned “Additional Disclosures Required by State Law”. The instructions could be simple: “List all additional disclosures required by Section 5 of the FTC Act, the common law, and any applicable state franchise statute; do not duplicate disclosures contained in other Items.” The simple efficacy of this solution should be obvious—it segregates the information from the other 23 items, thus maintaining the essential integrity of the Franchise Rule disclosures, it simplifies compliance by franchisors, reducing the risk of inadvertent failure to make required disclosures because of piecemeal approaches, it assures that the franchisee receives all required disclosures in one document, and it leaves franchisors and the industry freedom to draft the disclosures in the manner that is most helpful to them and to their franchisees. To some extent, what I am suggesting is giving official recognition and status (as an additional discrete Item) to the “Uniform State Addendum” that many franchisors now use with the approval of the states—but which might become a violation of the proposed Franchise Rule. My concern is simple: read literally, the proposed rule would prohibit including the California portion of the state addendum in the New York version of the Disclosure Document—because the California portion is not “required” by the New York statute. In order to comply with the Rule, every national franchisor would have to have at least fifteen different forms of Disclosure Document. By adding a new “additional state disclosures” Item, and making

it clear in the rule that a multi-state approach is acceptable, you avoid that multi-document issue and assure the franchisees maximum disclosure—in one readable document. A side benefit, of course, is that franchisees in different states can see the benefits that residents of some other states receive from their state statutes.

Updating Disclosures.

The proposed rule eliminates the duty to update disclosures before making additional offers or sales—and substitutes a quarterly update requirement. Although the larger, established franchisors may, in most cases, be sufficiently capitalized and experienced to survive a bad experience, the vast majority of the newer and smaller franchisors cannot. It may be sufficient to defer “routine” updates (think Item 20 or Item 2), but if a franchisor gets hit by a materially adverse event, that should be disclosed before the franchisor offers or sells any more franchises. Examples might be widespread litigation by a significant number of franchisees—especially if the magnitude is such that, under GAAP, the franchisor should set aside a reserve to deal with the potential liability—and absolutely if the franchisor has significant risk of becoming insolvent or losing its trademark rights as a result of the event(s). I am aware of one franchise system now, with several hundred franchisees. Over half of the franchisees, according to reports, are not breaking even. The franchisor is about to face litigation from at least 50 and probably over 100 of its franchisees. The franchisor knows what is coming. That system is seriously at risk—and should be required to disclose the current events before offering or selling to any more victims. I urge the commission to mandate immediate disclosure of such “materially adverse events”.

Exemptions.

The current proposal would exempt numerous categories of franchise transactions from the coverage of the rule. However, because state statutes that mandate disclosure to all prospective franchisees, including those exempted under the proposed Franchise Rule provide greater protection to franchisees, the state statutes would not be preempted. I think the Commission is doing franchisors (and especially the newer, smaller franchisors) a serious disservice by not clearly pointing out in the text of the exemption section that the exemptions may not apply in some states. Because of the credibility of the FTC, there will be a tendency in the industry to believe that an exemption under the rule equals an exemption from disclosure. It does not. I understand the desire to minimize the number of words in the rule, but this would take very few syllables to provide a much needed caution to franchisors.

Materiality Definition.

At the risk of redundancy, the Commission should add the definition of “Material” in §436.1. I strongly recommend the Commission adopt the definition as set forth in the current Franchise and Business Opportunity Rule—which is based upon the securities law definition:

“The terms “material” “material fact,” and “material change” shall include any fact, circumstance, or set of conditions which has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in the making of a significant decision relating to a named franchise business or which has any significant financial impact on a franchisee or prospective franchisee.”

Failing to provide this essential definitional guidance will reopen the arguments that (a) the Commission must have intended to reject the tried and true definition in favor of something else and (b) that the definition should be franchisor-focused instead of franchisee focused. Failing to maintain this clear and consistent definition of “material” will predictably result in the same level of confusion over the definition as currently exists over the various state definitions of a “franchise” or the definition of “renewal”. The Commission should address the issue now and save itself and the entire franchise community the enormous cost of arguing and litigating over such a well-established definition.

Obligation to Furnish Documents.

Section 436.2 is a significant improvement with one exception: Section 436.2 (c) states that, if the franchisor has done one of three things, then it has satisfied the requirement to “furnish” the documents. The second thing a franchisor could do to satisfy the “furnish” requirement would be to provide “directions for accessing the document on the Internet. . .” This is a huge invitation to abuse. Literally, a franchisor could provide the prospective franchisee with instructions for accessing the documents on the Internet and satisfy the requirement even though the franchisor knew that the franchisee did not have Internet access. A franchisor could provide a franchisee with a complex multi-step procedure for accessing the documents on the Internet in such a way that gave only a short period of access to the document—if the franchisee went through the complex steps to access it—unless the franchisee went through additional complex steps to download it during the same session. A franchisor could frustrate a franchisee’s efforts to obtain the document by simply placing the disclosure document on a slow server with limited bandwidth—so that a download could take hours to complete.

Although I am one of the most vocal advocates of permitting disclosure over the Internet, I urge the commission to add a requirement that the franchisor obtain proof that the franchisee actually received the Disclosure Document. You could leave franchisors with great latitude as to how they prove it (receipt, click-through records, electronic signature, or paper). Anyone who has ever tried to purchase software or legal forms over the Internet understands that having a three page set of detailed, step-by-step instructions on how to obtain your password and how to use the password to obtain what you want is NOT the equivalent of receiving the thing you seek to purchase. Disclosure of all material facts is so important to franchisees—and, indeed is the heart of the FTC Franchise Rule’s mission—that the Commission should not leave any franchisor with such an easy vehicle to “comply” with the Rule without ever actually furnishing the disclosure to the franchisee. Please make the franchisor prove actual delivery.

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Litigation Disclosure.

I want to commend the Staff for its recommendation that franchisor-initiated litigation against franchisees be disclosed for one year. Although I would prefer several years of such history, the compromise of one year is acceptable. It provides the prospective franchisee with several very valuable and material bits of information: (a) if there is lots of collection activity, it would suggest an absence of profitability; (b) if there is a lot of relationship litigation, it would suggest systemic problems; and (c) if there is no enforcement litigation in a large system, it might suggest lax enforcement of system standards. The Commission should adopt the Staff's recommendation in this regard.

You have one typographical error in §436.5(c)(1)(iii)(B): The seventh word in the fourth line of the sub-paragraph should be "person" instead of "franchisor". This is in the context of the litigation disclosure. The requirement is to disclose the litigation of certain "persons" as defined. The sentence should read: "'Held liable' means that, as a result of claims or counterclaims, the person must pay money . . ." To limit the concept of "held liable" to "franchisors" materially diminishes the value of the disclosure. In the context of litigation disclosures, it is equally—and often more—important to know the outcome of litigation against officers and directors than just against the "franchisor".

Initial Fees.

The staff has done an excellent job in drafting the text of §436.5(e) (Item 5). Unfortunately, through oversight, the staff has kept a title that is misleading. Contrary to the text of the Item 5 requirement, the title suggests a limitation to only those "Initial Fees" paid "to Franchisor". The text makes clear that the term "Initial Fees" includes fees paid to affiliates and others under certain circumstances. I encourage the Commission to clarify the title by just renaming it "Initial Fees".

Initial Investment.

I am concerned about a hidden fraud or deceit under the existing and proposed Item 7 (§436.5(g)). Nowhere in Item 7 (or elsewhere in the Disclosure Document) would the Commission require the franchisor to disclose the total amount of the franchisee's investment. It is rare to meet a franchisee or prospective franchisee who has not been deceived about the amount of the total investment—even though the franchisor made all disclosures literally required by the Franchise Rule and UFOC Guidelines. We often speak with franchisees and prospective franchisees who, for example, thought their entire investment would be \$100,000 (per Item 7 and the cover page) when, in fact, it was more like \$600,000. The discrepancy occurs because franchisors are not required to disclose obligations to third parties (beyond the first 90 days in practice) that the franchisee is almost always required to personally guaranty. The two biggest items are (a) the real estate lease and (b) equipment financing or leases. This omission can hide from unsophisticated franchisees (yes, that is usually a redundant characterization) as much as 80 to 90 percent of their total investment in the franchise business. Although failure to

make the disclosure violates the state statutes that are based on Securities rule 10(b)(5), and probably violates the common law fraud duty to speak doctrine, most franchisees do not have the benefit of such a statute and most cannot afford to enforce their common law rights and any statutory rights they may have. By the time they realize their rights have been violated, their resources are almost always depleted. The cost of enforcing those rights increases because, under the rule as proposed, every franchisor would defend by saying “the FTC Rule prohibits us from giving you that information—and we were just complying with the rule.” We all know that should be a losing defense and would be in most appellate courts, but it plays well with arbitrators and trial court judges. I urge the Commission to expressly require (or at least permit) this additional clarifying disclosure.

The solution to the “total investment” problem is simple. The Commission should require the following simple disclosure:

Disclose the total amount (in a range, if appropriate) of all obligations to third parties during the entire initial term of the franchise that will be necessary to operate the franchised business (including real estate leases and equipment leases) that the franchisee may be required to personally guaranty.

The logical place to insert this clarification would be immediately following the table in Item 7—or find a way to incorporate it into the table. This would give prospective franchisees very important information in estimating what they need to realize as a return on investment in light of the true picture of the amount of their risk and the size of their investment.

Technology Disclosures.

The staff has generally improved the technology disclosure requirement of §436.5(k) (Item 11) by simplifying it and reducing the quantity of complex data that is often out of date before it gets to the franchisee because of the rate of change in certain technology segments. However, the staff has missed one increasingly important disclosure issue: franchisees need disclosure if the franchisor requires (or can require) them to use proprietary technology that they have had developed for them or plan to have developed. Some of the problems we see are proprietary technology that feeds gross revenues quickly and directly to the franchisor but makes it very difficult for the franchisee to obtain information that the franchisee needs to operate the business, pay taxes, etc. Often, with proprietary systems, the ability to improve or update the system (to fix flaws or permit it to run on modern operating systems) is dependent upon one technician—who is someone’s step son. The franchisees need to understand if, by signing the franchise agreement, they are sentencing themselves to dealing with such frustrations or if they can reasonably expect the software to be regularly and professionally updated and improved and debugged. They need to know whether they have the right to use alternative “off-the-shelf” software in lieu of or in parallel with the required software if it does not work or if it does not produce the information they need because of local or state laws or the competitive environment. They need to know if the required software will not interface with or communicate with common software tools such as Microsoft Office or Outlook.

They need to know if the accounting functions comply with the legal and tax requirements of the IRS and their state—and if they will be updated if those requirements change. Finally, they need to know the true cost of the software if it is not included in the initial franchise fee and royalties.

We see few complaints (other than those common in the universe) involving off-the-shelf software. We hear constant complaints about “proprietary” software that seems to almost never work—and which franchisees are asked to replace and update at their cost on a frequent basis as the franchisor and its consultants struggle to figure out how to debug a defective code. The Commission should take a hard look at requiring some extensive disclosures regarding any proprietary software the franchisor requires the franchisee to use.

Renewal.

The Commission is familiar with my concerns about the subject of “renewal” of franchises. Although I understand the staff’s stated reasons for not wanting to adopt a different word and require everyone to use it, I urge the staff and the Commission to re-think the nature of the disclosure needed. Over the next five years, I predict that litigation over this disclosure item will approach the level of litigation over territorial encroachment. There is a widespread disconnect between what franchisees believe and understand based on use of the word “renew” and what franchisors mean when they promise “renewal” under certain conditions.

I think this problem calls for a novel approach—akin to the mandatory “negative disclosure” required in several other Items. I propose that, unless the franchisor promises to “renew” the franchise on substantially the same terms and conditions that the franchisor be required by the Franchise Rule to give a disclosure in something like the language I proposed earlier in my comments dated December 21, 1999 (Comment 18). Alternatively, the Commission should require a simple statement such as:

We do not give you the right to renew or extend your franchise on the same terms as your current franchise agreement. You should consult your franchise attorney about the consequences of this.

Financial Performance Information.

I commend the Commission staff for adding a required preamble to Item 19 advising franchisees that franchisors are permitted to provide truthful financial performance information. The Staff Report also improves Item 19 by removing the requirement that Item 19 disclosures have to comply with GAAP—which would discourage almost all franchisors from making essential disclosures. These changes cure about five percent of the problems with the current Item 19.

Regrettably, the Commission staff persists in refusing to mandate financial performance disclosures—even in situations where the negative disclosure is clearly part of a

fraudulent cover-up. I am familiar with one well-known franchise system where over half of the franchisees are reportedly not breaking even. The franchisor does not disclose the truth to prospective franchisees. I am familiar with another system where the gross revenue-only disclosures provided by the franchisor were true—but only because the franchisor, at those company stores, spent almost \$40,000 per month on advertising instead of the \$2,000 per month disclosed in Item 7 and discussed with the franchisees before sale. The franchisor pumped in that kind of money for the express purpose of making the company-owned units look successful to prospective franchisees, but never disclosed it. Under the revised Franchise Rule as proposed by the Staff Report, such fraud would apparently comply with the Rule.

Without repeating all of the arguments and reasons I and others have previously articulated for mandating full financial performance disclosures with information from existing units, suffice it to say that the reason the franchisor community so vigorously resists mandatory disclosure, in our experience, is to hide the truth—that the existing outlets are not truly profitable. Given the fact that the average franchisee whose business fails loses several hundred thousand dollars and often has to file a personal bankruptcy, the relatively slight cost to franchisors, given a reasonable phase-in period, to collect and report reasonably accurate data is a very small price to pay. In our view, it would result in many people not investing in unprofitable franchises that they now invest in because they get sold the “sizzle” while the absence of any meat is carefully covered up through a negative Item 19 disclosure combined aggressive “puffing” by the franchise sales people. I urge the Commission to reverse the position recommended by the Staff Report on this one issue of critical importance to franchisees—and to legitimate franchisors who would benefit from the comparisons that full disclosure would make possible. No rational person ever invested in a business without some expectation that they would make a profit. Franchisors are adept at using branding “sizzle” and sleight of hand to give franchisees the expectation of profitability they need and want—just keeping it vague and general enough to not “get caught”. Unfortunately, there is almost always a huge disconnect between the truth and the puffing. In my view, to adopt the Staff Report on this issue would be tantamount to specifically approving and endorsing the most horrible fraud currently occurring in the franchising industry. I urge your careful reconsideration here.

Outlets and Franchisee Information.

Although I generally defer to the greater expertise of Eric Karp regarding Item 20, I have observed one definition that will create the opportunity for material deception by franchisors. The problem occurs in §436.5(t)(2)(ii)(E) (following Table No.3). That section defines “termination” for purposes of Table No. 3 as being termination before the end of the term “without providing any consideration to the franchisee . . .”. There is rarely, if ever, a termination of a franchisee where the franchisor does not take the position that the franchisee owes some money. Because franchisors hate to disclose terminations (they want them called anything else), the standard practice will be to “forgive” one dollar (or more) of the amounts owed in every case and thereby giving themselves a justification to move the disclosure from Column 5 to Column 8. That

simple sleight of hand hides from the prospective franchisee the truth that the franchisor terminated the franchisee. Unless the Commission closes this enormous disclosure loophole by revising the definition, the Commission may as well just eliminate Column 5—it will almost never be used by franchisors anyway. I propose the Commission revise the definition of “termination” in §436.5(t)(2)(ii)(E) by simply deleting the entire portion of the sentence following the words: “prior to the end of its term.”

Confidentiality Clauses.

The definition of “Confidentiality Clause” in §436.1(c) contains an ambiguity. I would recommend changing the second sentence to read: “It does not include confidentiality clauses, *the sole purpose of which are to* protect franchisor’s trademarks or proprietary information.” Without such a clarification, a franchisor can avoid disclosure by simply inserting language in every “confidentiality clause” expanding its coverage to include “trademarks or proprietary information”. With this simple definitional clarification, then §436.5(t)(7) would provide franchisees with good material information. It would let them know that they should ask any current or former franchisee whether they signed such a clause and it would let them know that they probably cannot rely upon any information that the current or former franchisees might provide.

Franchisee Associations.

The Commission should adopt the Staff’s recommendation that franchisors include in Item 20 basic contact information for independent franchisee associations that are brand-specific. On the other hand, the Commission should revise the “optional statement” by deleting the second sentence that reads: “We do not endorse these organizations and their members may not represent all franchisees . . .” The first sentence is an appropriate neutral statement and should be required to place the information in context. The second sentence, which I recommend deleting, is an inappropriate derogatory comment on the association(s). It is calculated to send a not-too-subtle signal to prospective franchisees that it is not in their best interests to become identified with such “renegade groups”. We certainly would not ask franchisors to say that “these groups represent all of our franchisees and you should get involved”, but, out of fairness, the Commission should not sanction a statement that discourages participation.

With regard to qualifying franchisee associations, the Commission should not limit eligibility to associations organized as “corporations”. There is no reason to exclude associations just because they are organized as a limited liability company or otherwise. I recommend including any form of independent entity requiring formal creation under the entity laws of a state.

Financial Statements/

I commend the Commission Staff for mandating the inclusion of audited financial statements for the relevant subfranchisor. This plugs a major gap in the existing Rule’s disclosure provisions—which have resulted in franchisors delegating their contract

performance to subfranchisors about whom franchisees lack material information. Many times the contract specifically limits the franchisee's recourse for contract performance issues to the subfranchisor—but no one ever informs the franchisee that the subfranchisor is an insolvent “empty shell” entity or has other material issues. If the Commission will adopt the Staff recommendation and then enforce the rule, this proposed change will provide franchisees with a very important piece of information.

Instructions for Preparing Disclosure Documents.

The Commission needs to give some thought to the practical application of and compliance with §436.6(f) which requires that “Before furnishing a disclosure document, the franchisor shall advise . . . of the formats. . .” I fear that, in practical application, the requirement borders on the nonsensical. It creates a pre-disclosure disclosure requirement without any guidance as to how to accomplish it. In my view, it creates a technical trap for franchisors that many will fall into. For those who try to comply it might add several steps and several additional pieces of potentially confusing paperwork to the process. The unscrupulous in the industry will decide that they have complied if they give the pre-disclosure disclosure in a format that they know the franchisee will not receive or understand. Meanwhile, responsible franchisors will be unduly burdened by trying to make the pre-disclosure disclosure on paper, taking a matter of several extra days plus the cost of preparation and mailing and of maintaining records.

I propose that the Commission either eliminate the pre-disclosure requirement on the basis that the franchisor bears the burden of delivering the disclosure document to the franchisee, and let them figure out how to prove it or, alternatively, simplify the requirement by having the franchisor add language to the first page (cover) of the UFOC indicating the formats in which the document is available and any special tools necessary to receive or view it in each format. To not detract from the current cover page information, the format information could be placed in the lower right corner of the page in a box. It could include a telephone number or e-mail address to obtain further information or assistance. The commission could limit the list to the three or four preferred formats (one of which must be paper)—to keep the disclosure from filling the page. Using this approach would provide every franchisee with information about how to obtain additional copies in alternative formats.

Disclosures In Connection with Sale of Existing Franchises.

Section 436.9(f) would require a franchisor to provide a copy of an existing disclosure document to a prospective purchaser of an existing franchise outlet, upon reasonable request. At least one commenter has criticized this proposal as putting a franchisor at increased risk of litigation by the franchisee. Everyone seems to recognize that the Staff does not propose requiring the franchisor to create a new disclosure document if for some reason a current document is not available relevant to the particular outlet. Everyone also seems to recognize that the proposed requirement would not bar a franchisor from sending the “existing” disclosure document with a cover letter that alerted the franchisee that the Disclosure Document was not current or up-to-date. The value of having the

latest easily available disclosures about the franchisor and the franchise system far outweighs the cost of the prospective purchaser making a decision without receiving such easily deliverable material information.

Regarding the articulated concern that providing such a “non-current” disclosure document might increase the franchisor’s risk of litigation, I think the concern is greatly overstated. On balance, I think that the litigation risk is much greater if the franchisor fails to provide the basic disclosure document information—at least if it would have been as easy as pulling a book off a shelf. Those are facts that play well with judges, juries and arbitrators. In addition, except to the extent the proposed rule permits additional disclosures required by state law, I do not anticipate franchisors developing or maintaining different disclosure documents from state to state or region to region for the same brand. If the franchisor is still active anywhere in the United States, offering and selling franchises under that brand, the franchisor will necessarily have a current and up-to-date disclosure document. Because part of what a purchaser of an existing franchise is buying is a relationship with the franchisor that purchaser needs and deserves full disclosure.

This whole issue may be a tempest in a teapot. It would be highly unusual for an existing franchise to be sold if the franchisor is no longer offering or selling franchises in the United States—and if that were to happen, that very fact is material information the prospective purchaser would be entitled to receive. Even in that unlikely event, having the information that was available and included in the latest available disclosure document would be valuable information to the prospective purchaser. With the ability to tell the prospective purchaser that the information was accurate and complete as of the date on the cover, but has not been updated, the probability of civil liability arising out of providing the best available information is nearly non-existent—and particularly when the Franchise Rule specifically sanctions it.

I see the greatest risk to the franchisor in this franchise sale scenario arising, not under the Franchise Rule, but under the state anti-fraud (modeled after rule 10(b)(5) statutes and under the common law fraud and especially the duty to speak doctrine. Query how any franchisor can approve any franchise purchaser to assume the duties and benefits under a franchise agreement without answering questions and giving additional information that would require virtually all of the disclosures listed in the proposed rule—in order to make the statements made, in light of the circumstances under which they were made, not misleading. In most cases, the franchisor requires the purchaser to enter into a new “current version” of franchise agreement—and in those cases disclosure would be mandatory in any event—even if it meant creating a new conforming disclosure document.

Waivers.

Section 436.9(i) would prohibit certain disclaimers or waivers. Then it contains a proposed “proviso” that the Commission should reconsider carefully. The problem is that the exception is too broad and could subsume the Rule. Literally read, the proposed

language would permit a franchisee to waive any contract terms “during the course of franchise sale negotiations.” This loophole would permit a franchisor to initiate negotiations and to agree to “let the person become a franchisee” only if they agreed to waivers of essential terms. The franchisor could do this in a few cases or as part of a pattern with all its franchisees. To avoid this problem, I propose the Commission modify the proviso by limiting it to negotiations initiated by the prospective franchisee and that result in changes that are no less favorable to the franchisee than the standard terms. Although still not perfect such a change would narrow the window of opportunity for abuse.

Although §436.9(i) is an improvement over the current regulatory state of affairs, it does not go far enough to protect franchisees. It still permits franchisors to use integration clauses and other “waiver” provisions to force franchisees to waive their rights under the proposed rule in substantial part, if not totally. In a culture that places increased emphasis on personal responsibility, no one can reasonably argue that a franchisor should be able to disclaim statements made to a prospective franchisee in writing or other tangible media; no one can reasonably argue that the franchisor should be able to disclaim statements made by its employees and agents within the scope of their agency. Labeling them “rogue” is no substitute for the franchisor necessarily taking full responsibility for training and supervising its agents whom it places in a position to defraud potential franchisees.

I propose that the Commission make the change I recommended above to limit the scope of any waiver to negotiated changes initiated by the franchisee and that are more favorable to the franchisee than the standard document. In addition, the Commission could solve the integration/waiver problem by simply adding a sentence to §435.9, as follows:

(k) Require or cause a franchisee, as a condition of entering into or continuing in a franchise relationship to, directly or indirectly, waive any rights under this Rule.

This simple additional prohibition should take care of the real problem, be narrowly focused to just address rights under the Rule and avoid all of the expansive definitional issues arising out of the debate in the earlier comments.

Other Laws, Rules, Orders.

I commend the Commission Staff for doing an excellent job in drafting the proposed §436.10. It is easy to read and understand.

Separate Business Opportunity Rule.

I commend the Commission Staff for recommending a separate Business Opportunity Rule. The change is a needed recognition that so called “business opportunities”

constitute a discrete regulatory concern. It simplifies the Franchise Rule so that, in my view, more readers can truly understand their rights and responsibilities.

Conclusion.

I thank the Commission and the Commission Staff for their hard work on the Rule. Although, as stated above, I continue to have specific concerns about the Rule as proposed, overall, the Staff's work product is a significant step forward in providing prospective franchisees with the type and quality of information they need to make good decisions whether to invest in a particular franchise.

In most cases, our franchisee clients leverage every asset they have (including their home and their retirement) to invest in a franchise. In too many cases, they lose everything because they did not receive adequate or truthful or complete pre-sale disclosure. I urge maximum disclosure requirements because I understand the franchisor mentality—that says that IF they formalistically comply with the FTC Rule (or UFOC Guidelines) they effectively have a “safe harbor”. I think it is important that the Commission set the bar at a fairly high level—in part because the bar you set becomes not only the minimum but the maximum standard for disclosure in a competitive industry. You should seize every possible opportunity (such as mandating historical financial performance information) to expose the fraud that is still rampant in franchising in America.

Thank you, again, for considering these comments.

Sincerely,

Howard E Bundy

Howard E Bundy